No. 15781

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of George Miller, Deceased.

Appellants,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of Delcon Corporation, Bankrupt,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

OPENING BRIEF OF APPELLANTS.

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TOPICAL INDEX

PAGE

Introductory statement 1

Jurisdictional statement 3

Questions presented for decision 4

Formal findings of the referee 9

Order of the District Judge 9

Argument 11

I.

The validity of the instant purchase money mortgage is determinable under the laws of the State of California 13

II.

Under the California State law a mortgage is a contract vesting in the mortgagee a property interest 14

III.

Under the California law creditors coming into existence after the recordation of a chattel mortgage cannot attack its validity on the basis of its prior late recordation 15

IV.

Furthermore appellants' purchase price mortgage is valid against all creditors whether existing prior or subsequent to its recordation for these additional reasons: A. Civil Code, Section 2957, requiring recordation of ordinary chattel mortgages, does not apply to purchase price mortgages. B. Under the undisputed facts the delay of recordation was excusable 19

V.

Appellants' chattel mortgage is valid as against the creditors coming into existence after its recordation 22

VI.

There is no basis to justify a personal money judgment against the appellants and at the same time to deprive them of their property right and interest in the mortgaged chattels 26

Conclusion 28

Appendix. Excerpts from pertinent citations ..... App. p. 1

TABLE OF AUTHORITIES CITED

CASES PAGE

Bank of California v. McCoy, 23 Cal. App. 2d 192, 72 P. 2d 923 14

Bank of California v. Sampsell, 114 F. 2d 211 ..... 13, 17, 19

Consorto Construction Co., Inc., In re, 212 F. 2d 676 18

Erie Railroad Co. v. Tompkins, 304 U. S. 64, 82 L. Ed. 787, 114 A. L. R. 1487, 58 S. Ct. 817 13

Gage v. Jordan, 23 Cal. 2d 794, 147 P. 2d 387 16

Helvering v. United States, 317 U. S. 54 13

Higgs, In re, 126 Fed. Supp. 16 13

Industrial Finance Corporation v. Capplemann, 284 Fed. 8 27

Lustron Corporation, In re, 184 F. 2d 789 13

McLaughlin, Estate of, 97 Cal. App. 485 14

Mercury Engineering, In re, 60 Fed. Supp. 376 19

Metropolitan Water Dist. v. Adams, 32 Cal. 2d 620, 197 P. 2d 543 12

Moore, In re, 281 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133 24

Mortgan v. Commissioner, 309 U. S. 78 13

Patterson, In re, 139 Fed. Supp. 830 13

People v. Moroney, 24 Cal. 2d 638, 150 P. 2d 888 12

People v. Trieber, 28 Cal. 2d 657, 171 P. 2d 1 12

Roder v. Boyd, 252 F. 2d 585 28

Rupley v. Johnson, 120 Cal. App. 2d 548 11

Schwartzler v. Lemas, 11 Cal. App. 2d 442, 53 P. 2d 1039 16

Swift v. Higgins, 72 F. 2d 791 ..... 17, 19

Tyson v. Romey, 88 Cal. App. 2d 752, 199 P. 2d 721 22

United States v. Green, 78 S. Ct. 649 24

United States v. Nathanson, 60 Fed. Supp. 193 13

United Bank v. Powers, 89 Cal. App. 690 16

Warner v. Kenny, 27 Cal. 2d 627, 165 P. 2d 889 12

Wolfert v. Gripton, 213 Cal. 474 27

STATUTES PAGE

Bankruptcy Act, Sec. 24 4
Bankruptcy Act, Sec. 57(g) 12
Bankruptcy Act, Sec. 60 12
Bankruptcy Act, Sec. 70 12
Bankruptcy Act, Sec. 70(e) 9, 29
Bankruptcy Act, Sec. 72(g) 10
Civil Code, Sec. 2957 ..... 15, 17, 19, 22
Civil Code, Sec. 2973 15
Civil Code, Sec. 3440 ..... 17, 19
United States Code, Title 28, Sec. 1291 4
United States Constitution, Fifth Amendment 14, 23

TEXTBOOKS

2 California Jurisprudence 2d, p. 772 21
10 California Jurisprudence 2d, p. 308, par. 28 15
10 California Jurisprudence 2d, p. 376, par. 76 26

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OPENING BRIEF OF APPELLANTS.

Introductory Statement.

This appeal concerns a controversy between appellants (holders of a purchase money chattel mortgage) and appellee (trustee in bankruptcy) involved in an involuntary bankruptcy case pending in the District Court of the United States, Southern District of California, Central Division.

Appellants' purchase money chattel mortgage was recorded on *August 19, 1954, which was more than four months prior to the filing of the involuntary petition in*

the pending bankruptcy case. On October 24, 1955, appellants filed a verified proof of claim in the bankruptcy case alleging that they held a purchase money chattel mortgage lien on specified assets of the bankrupt in the amount of $141,742.50. On July 5, 1956, the trustee in bankruptcy filed objections and a counterclaim thereto (which was thereafter amended) alleging that appellants' chattel mortgage was void in its entirety against all creditors, due to its late recordation.

On May 6, 1957 an order was made by the Referee that the chattel mortgage was not void in its entirety; that it was void only in the amount of $8,906.95 (same representing the amount of provable claims of the existing creditors *prior to the recordation* of the chattel mortgage on August 19, 1954; but that it was valid against the provable claims of the creditors who came into existence *after the recordation of the chattel mortgage on August 19, 1954.*

On May 21, 1957, the trustee in bankruptcy filed a petition for review of the Referee's order alleging that the Referee erred in his conclusion of law that the chattel mortgage was void only to the extent of the provable claims which arose prior to the recordation of the chattel mortgage, and that it was valid against the claims of the creditors who came into existence after the recordation of the chattel mortgage.

On July 30, 1957, an order was entered by the District Judge sustaining the Trustee's petition for review and adjudging that the chattel mortgage was void in its entirety against all creditors, including those who came into existence after the recordation of the mortgage (albeit the chattel mortgage liens had been duly perfected

more than four months prior to the filing of the involuntary petition in the bankruptcy matter).

On August 12, 1957, a notice of appeal was filed by appellants to this Honorable Court from the order of the District Court reversing the aforesaid order of the Referee [R. p. 70].

Jurisdictional Statement.

I. Jurisdiction in the District Court is vested by virtue of the provisions of the Bankruptcy Act as amended; and it is based on the following proceedings and pleadings in the pending bankruptcy case.

1. The involuntary bankruptcy petition filed February 23, 1955 [R. p. 3].

2. The order of general reference filed February 23, 1955 [R. p. 6].

3. The order of adjudication entered by the Referee on March 16, 1955 [R. p. 6].

4. The order appointing appellee trustee entered by the Referee on April 25, 1955 [R. p. 7].

5. The verified proof of claim filed by appellants on October 24, 1955 [R. p. 8].

6. The objections and counterclaim to appellants' aforesaid proof of claim filed by the trustee on July 5, 1956 [R. p. 16].

7. The answer to said objections and counterclaim filed by appellants on August 20, 1956 [R. p. 20].

8. The amendment to his counterclaim filed by the trustee on November 28, 1956 [R. p. 30].

9. The findings of fact, conclusions of law and order of the Referee filed on May 6, 1957 [R. p. 53].

10. The petition for review from the Referee's aforesaid order filed by the trustee on May 21, 1957 [R. p. 60].

11. The order of the District Judge reversing the order of the Referee filed on July 30, 1957 [R. p. 63].

II. Jurisdiction is vested in this court under Section 24 of the Bankruptcy Act and 28 U. S. C., Section 1291.

III. The facts disclosing the basis of jurisdiction of the District Court and of this court are set forth in the Findings of the Facts of the Referee which were adopted by the District Judge.

Questions Presented for Decision.

The facts are not in dispute. They are summarized (a) in the Referee's memorandum decision [R. beg. at p. 32]; (b) in the findings of facts of the Referee [R. beg. at p. 53]; and (c) in the order of the District Judge upon the trustee's petition for review [R. beg. at p. 63].

The legal issues presented for decision are as follows:

I.

DOES THE CALIFORNIA STATE LAW REQUIRING PROMPT RECORDATION OF CHATTEL MORTGAGES APPLY EQUALLY TO RECORDATION OF PURCHASE PRICE CHATTEL MORTGAGES?

II.

ASSUMING THAT THE CALIFORNIA STATE LAW REQUIRING PROMPT RECORDATION OF ORDINARY CHATTEL MORTGAGES IS EQUALLY APPLICABLE TO RECORDATION OF PURCHASE PRICE MONEY MORTGAGES, WAS THE DELAY OF 79 DAYS OF THE RECORDATION OF THE INSTANT PURCHASE PRICE MORTGAGE JUSTIFIED UNDER THE FINDINGS OF THE COURT?

III.

ASSUMING THAT SUCH DELAYED RECORDATION OF THE CHATTEL MORTGAGE WAS NOT JUSTIFIED UNDER THE CALIFORNIA STATE LAW, WAS THE CHATTEL MORTGAGE BY REASON THEREOF VOID AGAINST THE BANKRUPT'S CREDITORS WHO CAME INTO EXISTENCE AFTER THE RECORDATION THEREOF ON AUGUST 19, 1954, WHICH WAS MORE THAN FOUR MONTHS PRECEDING BANKRUPTCY?

IV.

DID CONGRESS HAVE THE CONSTITUTIONAL POWER UNDER SECTION 70e OF THE BANKRUPTCY ACT TO DEPRIVE APPELLANTS OF THE SUBSTANTIVE PROPERTY RIGHTS ACQUIRED BY THEM UNDER THEIR PURCHASE PRICE MORTGAGE CONTRACT UNDER THE CALIFORNIA STATE LAW?

V.

IN ANY EVENT, WERE APPELLANTS GUILTY OF CONVERSION OF THE MORTGAGED CHATTELS BY THEIR REPOSSESSION THEREOF ON DECEMBER 29, 1954 (PRIOR TO BANKRUPTCY) AND BY THEIR SUBSEQUENT SALE THEREOF (AFTER BANKRUPTCY) TO A BONA FIDE PURCHASER AT A SUM REPRESENTING THE FAIR VALUE THEREOF IN VIEW OF THE FOLLOWING FACTS:

1. THAT THE CHATTEL MORTGAGE WAS VALID ON THE DATE OF ITS EXECUTION AND DELIVERY ON JUNE 1, 1954 AGAINST ALL CREDITORS, AT WHICH TIME THE BANKRUPT WAS SOLVENT (WHICH WAS MORE THAN EIGHT MONTHS PRIOR TO BANKRUPTCY).

2. THAT APPELLANTS HAD THE LEGAL RIGHT TO THE REPOSSESSION OF THE MORTGAGED CHATTELS IN DECEMBER OF 1954 UNDER THE EXPRESS TERMS OF THE VALID PURCHASE PRICE MORTGAGE, THE BANKRUPT THEN BEING IN DEFAULT THEREUNDER.

3. THAT NO DEMAND HAS BEEN MADE ON APPELLANTS FOR THE SURRENDER OF THE REPOSSESSED MORTGAGED CHATTELS AND APPELLANTS WERE THEREFORE IN LAWFUL POSSESSION THEREOF SINCE DECEMBER, 1954.

Statement of the Case.

For the convenience of the court, the undisputed facts epitomized in the Referee's memorandum decision are briefly restated. In sum and substance they are as follows:

The involuntary bankruptcy was initiated on February 23, 1955 [R. p. 33] which was followed by an adjudication on March 16, 1955 [R. p. 7].

Appellants (referred to in the record as the Miller partnership or family) had extensive business, commercial and financial interests, and operated a manufacturing business under the firm name of Miller Engineering Company. On June 1, 1954, the partnership sold its manufacturing business to the bankrupt for $200,000.00; the same included its physical assets and the right to use its business name. As part payment the bankrupt gave the Miller partnership its promissory note for $189,000.00, payable in installments and secured by the instant purchase price chattel mortgage on the physical assets involved in the sale. All the papers evidencing the sale were executed and delivered on June 1, 1954 [R. p. 33].

The papers were thereupon turned over by the partnership to its trusted employee who had been in its employ for some seven years and whose duty was, among other things, to attend to the recording of such papers as were required to be recorded [R. p. 33].

On or about August 2, 1954, and on the eve of an anticipated audit of the books of appellants' enterprise, appellants' trusted employee absconded and the auditors then found that he had failed to record the chattel mortgage. *Thereupon the chattel mortgage was recorded without any delay.* It was recorded on August 19, 1954,

which date was more than four months preceding the filing of the involuntary bankruptcy petition [R. p. 34].

On or about December 21, 1954, and prior to the initiation of the bankruptcy proceeding appellants took possession of such of the mortgaged chattels as they could find; appellants were authorized so to do under the express terms of the chattel mortgage, the bankrupt then being in default thereunder. *Appellants were in possession of the located repossessed mortgaged chattels at the date of the bankruptcy* [R. p. 34]; and in March, 1955, they were sold by appellants to a bona fide purchaser at the fair price of $82,500.00 [R. p. 34].

In connection with the repossession and sale of the located mortgaged chattels appellants incurred expenses in the sum of $14,019.32; and the net amount received by them was $68,480.68 [R. p. 34].

The provable claims of the existing simple creditors prior to the recordation of the mortgage amounted to $8,906.65 [Finding of the Referee, R. p. 56; and finding of the District Judge, R. p. 66].

On these undisputed facts the Referee stated in his memorandum *inter alia* (which was not gainsaid by the District Judge) as follows [R. pp. 36 and 37]:

> "We have here a situation which literally shocks the conscience of the Referee and, if the position of the trustee is supported by any of the provisions of the Bankruptcy Act, it might well be argued that such provisions are beyond the constitutional authority given to congress to establish uniform laws on the subject of bankruptcy throughout the United States (Constitution of the U. S., Article 1, section 8, clause 4; in re Philibosian, 1937, D. C. N. D. Georgia, 19 Fed. Supp. 787, 789).

"It will be admitted that in bankruptcy legislation Congress has power (1) to provide for equality among creditors by striking down preferences (sections 60 and 67(a) of the Bankruptcy Act); (2) to provide for the recovery of property fraudulently transferred (sections 67(d) and 70(a) 4 of said Act); and (3) to provide for the exercise of rights held at [56] bankrucpty by all or some of the creditors (sections 70(c) and 70(e) of said Act. *But the framers of the Constitution never intended that Congress should have the power to use a Bankruptcy Court as an instrumentality to plunder the strong boxes of unoffending folks and then to distribute the spoils to persons having neither legal nor moral right thereto, and it is our opinion that Congress has never attempted to do any such thing and that there is nothing in the Bankruptcy Act which supports the demands here made by the trustee against the Miller partnership,* except as to the credit extended prior to the recordation of the mortgage here in question." (Italics ours.)

At Record pages 41 and 42, the Referee further stated:

"It is clear that at the date of this bankruptcy the aforesaid creditors who, without actual notice of the Miller [59] mortgage, extended credit to the bankrupt prior to the recordation of such mortgage, had the right to assert that it was void as to them to the extent of the credit actually extended by them *prior to such recordation,* and it is equally clear that such right passed to the trustee in this case. However, the mortgage was not void as against such creditors as to credit extended by them if any such credit was extended *subsequent to the recordation.* Hence, the mortgage was not "voidable" by any of such creditors. Notwithstanding their rights, it remained in full force and effect as to all creditors who extended

credit after it was recorded. It simply was void as to credit extended prior to the recordation. (10 Cal. Jur. (2) 308; Wolpert v. Cripton, 1931, 213 Cal. 474; Bank of America v. Sampsell, 1940, C. A. 9, 114 Fed. (2) 211.)" (Italics ours.)

Formal Findings of the Referee.

In his formal findings the Referee made these supplemental findings:

1. That due to the neglect of appellants' trusted (but dishonest) employee the purchase money chattel mortgage was recorded on August 19, 1954, a delay of 79 days [R. p. 55].

2. That the repossessed chattels were sold by appellants to a bona fide purchaser, and the purchase price represented the true value thereof [R. p. 56].

3. That in December, 1954 (when the chattels were repossessed by the appellants) the bankrupt was insolvent, and *at that time* appellants had knowledge of the bankrupt's insolvency [R. p. 56].

The Referee did not find that the bankrupt was insolvent *at the time of the recordation of the chattel mortgage* on August 19, 1954.

Order of the District Judge.

After adopting and approving the formal factual findings of the Referee, the District Judge made these conclusions of law:

1. That under Section 70(e) of the Bankruptcy Act the chattel mortgage was void in its entirety against all of the creditors, including those who came into being after the recordation of the mortgage on August 19, 1954.

2. That the trustee was entitled *to a personal money judgment* against appellants in the sum of *$82,500.00;* same being the purchase price of the chattels received by appellants upon the sale thereof and representing its fair value. The judgment carried interest; and appellants were entitled to a credit for their expenses incident to their repossession of the chattels pursuant to the terms of the mortgage and their subsequent sale thereof [R. p. 67, Conclusion of Law IV].

3. That the case should be remanded to the Referee for a determination of the expenses incurred by appellants in connection with their repossession and sale of the mortgaged chattels [R. p. 68, Finding V].[1]

4. That under Section 72(g) of the Bankruptcy Act appellants were required to pay to the trustee the amount of the judgment and interest within 30 days; and that upon their payment thereof within the 30 days, appellants were granted the right to file a supplemental claim for the amount thus paid to the Trustee [R. p. 68, Finding VII].

---

[1]The memorandum decision of the Referee indicates that the statement of appellants that their expenses were in the sum of $14,019.32 was not contradicted by the trustee and its verity was not called into question by the Referee [R. p. 34, bottom paragraph].

ARGUMENT.

As noted in the forepart of this brief under the heading "Questions Presented for Decision" the questions posed by this appeal are solely questions of law.

We wish to preface the discussion of these legal questions by a restatement of the rule that court opinions do not rest on generalities and abstract principles having no relation to the factual situation presented by the record. It is well established that court opinions must be read in the light of the precise legal problems before the court in their application to the *factual record.*

We believe the best answer to the mistaken legal view of Judge Harrison that appellants' purchase price chattel mortgage was void *in toto,* is supplied by the learned and experienced Referee in his graphic and illuminating memorandum decision, wherein the underlying philosophy of the Bankruptcy law is comprehensively discussed.

Additionally, we wish to point to the following well established legal principles governing interpretation of statutes:

In *Rupley v. Johnson,* 120 Cal. App. 2d 548 at 553, the Court said:

> "The rule is well established that all of the statutory provisions in all of the codes must be read together and harmonized if possible.
>
> *In re Porterfield,* 28 Cal. 2d 91, at page 100 (168 P. 2d 706, 167 A. L. R. 675), the Court declared:
>
> " 'It is a well-recognized rule that for purposes of statutory construction the codes are to be regarded as blending into each other and constituting but a single statute. (Citing cases.)' "

Statutes should be read as a whole to determine the legislative intent.

People v. Trieber, 28 Cal. 2d 657, 663, 171 P. 2d 1;

People v. Moroney, 24 Cal. 2d 638, 642, 150 P. 2d 888.

Where a statute is susceptible of two constructions, the one of which leads to the more reasonable result will be followed.

Metropolitan Water Dist. v. Adams, 32 Cal. 2d 620, 630, 197 P. 2d 543.

Where the language of a statutory provision is susceptible of two constructions, one of which, in application, will render it reasonable, fair and harmonious with its manifest purpose, and another which would be productive of absurd consequences, the former construction will be adopted.

Warner v. Kenny, 27 Cal. 2d 627, 629, 165 P. 2d 889;

Gage v. Jordan, 23 Cal. 2d 794, 799, 800, 147 P. 2d 387.

We respectfully submit that Section 60 of the Bankruptcy Act (providing for perfection of liens in compliance with the state law) is *in pari materia* with Sections 57g and 70 of the Bankruptcy Act; they all must be read together and harmonized with the other related sections of the Bankruptcy Act; they blend into each other, and constitute but a single statute to determine the legislative intent implicit in the philosophy of the Bankruptcy Act construed as a whole.

Our argument, in support of the major contentions set forth in our Statement of Points relied on, is presented in the following order:

I.

The Validity of the Instant Purchase Money Mortgage Is Determinable Under the Laws of the State of California.

Erie Railroad Co. v. Tompkins, 304 U. S. 64, 82 L. Ed. 787, 114 A. L. R. 1487, 58 S. Ct. 817;

Bank of California v. Sampsell, 114 F. 2d 211;

In re Lustron Corporation, 184 F. 2d 789, 794;

In re Patterson, 139 Fed. Supp. 830;

In re Higgs, 126 Fed. Supp. 16.

In *Mortgan v. Commissioner,* 309 U. S. 78, the Supreme Court declared that legal interests and rights in property are created by the State law.

See also:

Helvering v. United States, 317 U. S. 54.

In *United States v. Nathanson,* 60 Fed. Supp. 193, the government sought to enforce collection of taxes assessed against the defendant from rents of property owned by the defendant and his wife by the entirety. Under the Michigan law the rents belonged to the husband; but they could not be reached by his creditors. It was the government's claim that the rents should be nonetheless seized by the government under the federal law. The government's contention was not sustained by the court, the court ruling that the Michigan law determined the property rights of the defendant.

II.

Under the California State Law a Mortgage Is a Contract Vesting in the Mortgagee a Property Interest.

In *Estate of McLaughlin,* 97 Cal. App. 485, the Court said at page 489:

> ". . . While in California it is true that a mortgage is not regarded as a conveyance to the mortgagee of any actual title to the real property (17 Cal. Jur. 714, sec. 19), yet it does create *an interest in the property* to the extent of the attachment of a lien to secure the enforcement of the obligation for the payment of which it is executed. . . ." (Italics ours.)

The primary purpose of a chattel mortgage is *to transfer title* of personalty to another as security for payment of money or performance of contract or other obligation.

> *Bank of California v. McCoy,* 23 Cal. App. 2d 192, 195, 72 P. 2d 923.

In addition to their rights as prior owners, it follows that appellants acquired *a property interest* in the mortgaged chattels on the date of its execution and delivery on June 1, 1954 (*about eight months preceding bankruptcy*); they were entitled to the repossession thereof in December, 1954, the bankrupt then being in default; and they were in lawful possession thereof when bankruptcy was initiated in February, 1955.

We point out *infra* that appellants could not be deprived of their property interest in the mortgaged chattels under the due process clause of the Fifth Amendment to the United States Constitution either by Congress, or the Judiciary, unless their power is asserted in conformity with the requirements of due process.

III.

Under the California Law Creditors Coming Into Existence After the Recordation of a Chattel Mortgage Cannot Attack Its Validity on the Basis of Its Prior Late Recordation.

The law covering the California law on the legal effect of a delayed recordation against creditors is summed up in 10 Cal. Jur. 2d, Paragraph 28 at page 308.

The code section governing recordation of chattel mortgages is Civil Code Section 2957, the relevant part of which is set forth in the Appendix. This code section does not specify any time within which a chattel mortgage must be recorded; and as far as the parties to the mortgage are concerned, recording is not necessary to its validity under Civil Code Section 2973, the text of which is set forth in the Appendix.

But the decisions construing Civil Code Section 2957 establish the law that immediate recordation is essential to the protection of creditors of the mortgagor; and if the recordation of the mortgage is withheld *beyond a reasonable time,* the mortgage is void as against the mortgagor's existing creditors.

However, the precise legal question on the present record concerns the legal effect of a delayed recordation only as against creditors who came into existence *after the recordation of the mortgage.*

We respectfully contend that the following California decisions sustain our contention that creditors coming into existence *after the recordation of the mortgage* are not in a legal position to attack the validity thereof on the basis of its delayed recordation occurring before the existence of such creditors.

In *United Bank v. Powers,* 89 Cal. App. 690, the Court said at page 694 and 695 as follows:

> ". . . As to the third assignment of error, the plaintiff in this action asks, if the court is at all in doubt as to the law involved, to be permitted, under section 956a of the Code of Civil Procedure (Stats. 1927, p. 583), to make proof that the chattel mortgage executed by Gonsalves to the plaintiff though bearing date of February 2, 1922, was in truth and in fact executed on the seventeenth day of February, 1922. We think the granting of this request, under the circumstances disclosed by the record in this action, unnecessary. Our attention has not been called to anything in the transcript, nor have we been able to discover any testimony therein indicating that the appellant in this action is in a position to take advantage of the lapse of time between the date of plaintiff's mortgage and the date of its recordation, assuming, for the purpose of this decision, that the number of days so indicated actually intervened between its execution and recordation, for the simple reason that the record does not show that the appellant parted with any rights, acquired any rights, had any business transactions with the mortgagor Gonsalves, or became a creditor of said Gonsalves during such period of time. The law is well established in this state that in such circumstances the appellant is unharmed and has nothing of which to complain. . . ."

In *Schwartzler v. Lemas,* 11 Cal. App. 2d 442, 53 P. 2d 1039, the Court said at page 449 as follows:

> ". . . On behalf of all of the appellants it is contended that the second mortgage was void for the reason that a number of weeks intervened between the execution and the recordation thereof. The cases cited, however, do not support the contention. It clearly appears in the cases of *Williams v.*

Belling, 76 Cal. App. 610 (245 Pac. 455); *Wolpert v. Gripton,* 213 Cal. 474 (2 Pac. (2d) 7676); *Noyes v. Bank of Italy,* 206 Cal. 266 (274 Pac. 68), and *United Bank & Trust Co. v. Powers,* 89 Cal. App. 690 (265 Pac. 403), that unless the party contesting the validity of the chattel mortgage appeared with some rights or became a creditor of the mortgagor *during the interval between execution and recordation,* such party is in no position to complain . . ." (Italics ours.)

In *Swift v. Higgins,* 72 F. 2d 791 (9th Cir.), Judge Wilbur declared that under the California law a chattel mortgage is void as against the general creditors of the bankrupt who were in existence *before recordation,* if the mortgage was not recorded within a reasonable time; and that a trustee in bankruptcy of the general creditors, whose claims arose *between the execution and belated recordation* may assert its invalidity *as to such creditors.*

In *Bank of California v. Sampsell* (9th Cir.), 114 F. 2d 211, this court declared in the opinion written by Judge Healy that the California chattel mortgage recording statute (Civ. Code, Sec. 2957) is in *pari materia* with Civil Code, Section 3440 and that a chattel mortgage is valid as against creditors who became such subsequent to recording. At page 213 of the opinion this court states:

> ". . . In effect, it would appear that the state courts have construed the word 'unless', as used in §2957, as the equivalent of 'until', since a chattel mortgage, although not promptly recorded, is good *as against creditors who become such subsequent to recording.* . . ." (Italics ours.)

Clearly, the instant chattel mortgage was valid under the California law as against the creditors who came into

being after its recordation. Furthermore, as above noted, appellants' chattel mortgage was recorded more than four months prior to the filing of the involuntary bankruptcy petition.

In this connection, it is not out of place to cite at this time the recent case *In re Consorto Construction Co., Inc.,* 212 F. 2d 676, which, like the case at bar, involved the validity of a chattel mortgage as against creditors who came into existence after recordation.

At page 679 Judge Hastie speaking for the Third Circuit said at page 679 as follows:

> ". . . But the same result can be obtained merely by re-executing the old unrecorded mortgage and recording this 'new' instrument at once. It seems worthless formalism to require such re-execution of the old instrument as a basis for effective recordation. We think that a chattel mortgage while unrecorded can be fairly recognized as having a potential like a pledge, originally ineffective for failure to deliver possession. In the latter situation, a subsequent delivery will generally perfect the pledge except as to bona fide purchasers *or creditors who have acquired liens prior thereto.* . . ." (Italics ours.)

> ". . . Here the chattel mortgagee obtained a lien August 3, the date of recording. Anyone subsequently obtaining an interest in or claim against the property was subordinated to that lien. Under Section 70, sub. c the trustee's position is that of such a subsequent lienor, 'holding a lien * * * by legal or equitable proceedings' as of the date of bankruptcy, a time more than four months after Equity perfected its mortgage lien. . . ."

It seems that the last cited case presents a realistic and logical approach to the solution of this problem.

IV.

Furthermore Appellants' Purchase Price Mortgage Is Valid Against All Creditors Whether Existing Prior or Subsequent to Its Recordation for These Additional Reasons:

A. Civil Code, Section 2957, Requiring Recordation of Ordinary Chattel Mortgages, Does Not Apply to Purchase Price Mortgages.

B. Under the Undisputed Facts the Delay of Recordation Was Excusable.

A.

We believe ground A *supra* finds support in the well reasoned opinion of Judge Yankwich in the *Mercury Engineering* case (60 Fed. Supp. 376) quoted from *in extenso* in the appendix.

The *Mercury* case *supra*, like the case at bar, involved a purchase price mortgage. While the precise legal point in the *Mercury* case centered on the applicability of Civil Code, Section 3440, the reasoning of Judge Yankwich, therein, is equally persuasive on the applicability of Civil Code, Section 2957.

As declared by Judge Healy in the *Bank of America* case *supra* (114 F. 2d 211) the California general recording mortgage statute (Civ. Code, Sec. 2957) is in *pari materia* with Civil Code, Section 3440. (See also *Swift* case *supra*, 72 F. 2d 791.)

Clearly, the objectives sought to be accomplished under Civil Code, Section 3440 is identical with the objectives sought to be accomplished under Civil Code, Section 2957. The underlying philosophy is the same, namely: to protect creditors against a sale or incumbrance of assets which in the statutory sense are deemed fraudulent

as a matter of law, though the elements of actual or constructive fraud are lacking.

It is inconceivable that it was the intent of the legislature (in the words of Judge Yankwich) "to penalize a seller of a going business for supplying to the buyer the very means of carrying on a trade" and thereby to unjustly enrich the creditors at the expense of the rightful owner of the property.

It is illogical to assume that it was the intent of the legislature to bring about such an inequitable and horrendous result, which is shocking and unconscionable legally and morally.

As it was well stated by the learned Referee [R. pp. 36-37]:

> ". . . We have here a situation which literally shocks the conscience of the Referee and, if the position of the trustee is supported by any of the provisions of the Bankruptcy Act, it might well be argued that such provisions are beyond the constitutional authority given to congress to establish uniform laws on the subject of bankruptcy throughout the United States (Constitution of the U. S., Article 1, section 8, clause 4; In re Philibosian, 1937, D. C. N. D. Georgia, 19 Fed. Supp. 787, 789)."

We will not belabor the discussion of the trustee's inequitable position any further, except to observe that the trustee's such position does not comport with the objectives implicit in the Bankruptcy Act which should be construed as a whole, and not in isolated sections.

B.

Moreover, under the undisputed facts the delay of the recordation was excusable. It was not caused by the neglect of the appellants; but it was caused solely by the dishonesty of their trusted employee.

What may be considered a reasonable time within which to record a chattel mortgage varies with the facts and circumstances of the case.

It requires no argument that appellants should not be held responsible for the acts of their agent who was bound to act faithfully and loyally.

It is well settled, as stated in 2 Cal. Jur. 2d at page 772 that:

> ". . . As a matter of law, the relationship of principal and agent binds the agent to the utmost good faith in his dealings with his principal, not only in form, but also in substance. This standard requires a high degree of honesty, loyalty, and integrity, and the most faithful service. The animating principle of the proposition is that no one should be permitted to enjoy the fruits of an advantage taken of a fiduciary relationship, whose dominant characteristic is the confidence reposed by one in another. The act of an agent within the scope of his authority of an agent is so fraught with responsibility and grave concern for his principal that it proceeds out of the highest considerations of confidence, which, the principles of equity demand, must be preserved to the utmost in transactions involving the exercise of such authority. . . ."

It is also well established that a principal cannot be held responsible to third parties for the negligence of his agents.

Tyson v. Romey, 88 Cal. App. 2d 752, 199 P. 2d 721.

We respectfully contend that the delay of the recordation of appellants' purchase price chattel mortgage (assuming that such was required under Civ. Code, Sec. 2957) was justified under the undisputed facts in this record.

It follows that appellants' chattel mortgage was valid against all of the creditors for all and each of the foregoing reasons.

V.

Appellants' Chattel Mortgage Is Valid as Against the Creditors Coming Into Existence After Its Recordation.

We respectfully contend that the contrary ruling of the District Judge is erroneous. We believe the memorandum decision of the learned Referee Brink is a conclusive answer to the legal weakness of the position of Judge Harrison. It is our considered judgment that the precise legal points *as applied to the facts on the present record* are clearly and explicitly analyzed in the lucid opinion of the Referee. They cannot be successfully assailed; and to save duplication we adopt the opinion of the Referee subject to a few additions and modifications noted below.

We wish to stress and restate these additional points:

1. Appellants' *substantive property rights* in the mortgaged chattels are determinable by the laws of the State of California; and the Bankruptcy Act prescribes only *the procedural means* for an equal pro-rata distribution of the assets of the bankruptcy estate among creditors of the same class, whose legal and equitable rights to such distribution must be weighed and measured by *the substantive law of the State of California.*

2. Under the applicable laws of the State of California appellants possessed a contractual property right and interest in the mortgaged chattels as against the bankrupt's creditors who became such after the recordation of the mortgage; and neither Congress nor the judiciary, had the constitutional power to wipe out or water down appellants' such contractual property rights under the due process clause of the Fifth Amendment to the United States Constitution.

3. Furthermore, as pointed out in the forepart of this brief appellants' chattel mortgage was valid in its entirety *against all of the creditors* for the reasons specified in heading IV *supra,* at pages 19-22.

4. As well stated by the Referee in his memorandum opinion [R. p. 37]:

". . . But the framers of the Constitution never intended that Congress should have the power to use a Bankruptcy Court as an instrumentality to plunder the strong boxes of unoffending folks and then to distribute the spoils to persons having neither legal nor moral right thereto, and it is our opinion that

> Congress has never attempted to do any such thing and that there is nothing in the Bankruptcy Act which supports the demands here made by the trustee against the Miller partnership, except as to the credit extended prior to the recordation of the mortgage here in question. . . ."

We are in full agreement with the Referee that the opinion written by Mr. Justice Holmes in the *Moore* case (281 U. S. 4, 52 S. Ct. 3, 76 L. Ed. 133) does not cover the precise legal points presented on the factual record herein. *Nor does it discuss the rights of a mortgagee under a purchase price mortgage.* Moreover, the precise constitutional question whether Congress had the constitutional power to deprive a mortgagee of his property rights was neither discussed, nor adjudicated in the *Moore* case.

Assuming, however, that the Moore case *supra* (on which Judge Harrison relied) may be considered as an authority as applied to the present case, we respectfully point out that the position taken by Judge Harrison raises a grave constitutional question which this court is called upon to resolve on the present factual record.

As stated by Mr. Justice Black in his dissenting opinion in the recent case of *United States v. Green*, reported in Volume 78 of the Supreme Court Reporter No. 11 at page 649 (with which the majority of the court was not in disagreement):

> ". . . Ordinarily it is sound policy to adhere to prior decisions but this practice has quite properly never been a blind inflexible rule. Courts are not

omniscient. Like every other human agency, they too can profit from trial and error, from experience and reflection. As others have demonstrated, the principle commonly referred to as *stare decisis* has never been thought to extend so far as to prevent the courts from correcting their own errors. Accordingly, this Court has time and time again from the very beginning reconsidered the merits of its earlier decisions even though they claimed great longevity and repeated reaffirmation. See e.g., Erie Railroad Co. v. Tompkins, 304 U. S. 64, 58 S. Ct. 817, 82 L. Ed. 1188; Graves v. People of State of New York ex rel. O'Keefe, 306 U. S. 466, 59 S. Ct. 595, 83 L. Ed. 927; Nye v. United States, 313 U. S. 33, 61 S. Ct. 810, 85 L. Ed. 1172. Indeed, the Court has a special responsibility where questions of constitutional law are involved to review its decisions from time to time and where compelling reasons present themselves to refuse to follow erroneous precedents; otherwise its mistakes in interpreting the Constitution are extremely difficult to alleviate and needlessly so. See Burnet v. Coronado Oil & Gas Co., 385 U. S. 393, 405, 52 S. Ct. 443, 446, 76 L. Ed. 815 (Brandeis, J., dissenting; Douglas, Stare Decisis, 49 Col. L. Rev. 735). . . ."

We respectfully contend that the order of the District Judge reversing the order of the Referee was erroneous.

VI.

There Is No Basis to Justify a Personal Money Judgment Against the Appellants and at the Same Time to Deprive Them of Their Property Right and Interest in the Mortgaged Chattels.

On this issue it would be helpful to restate the following:

1. The chattel mortgage was executed and delivered by the bankrupt to appellants on June 1, 1954. At this time the bankrupt was solvent. Therefore, the chattel mortgage (executed about eight months preceding bankrutcy) *was valid against the whole world.*

2. Under the express provisions of the chattel *mortgage contract* appellants were authorized to enforce their chattel mortgage either by foreclosure or by repossessing the mortgaged chattels (10 Cal. Jur. 2d, Par. 76, at p. 376). It is admitted that the bankrupt was in default in December, 1954. Therefore, appellant had the legal right to take possession of the located chattels in December, 1954, under the express provisions of *their chattel mortgage contract and under the laws of the State of California.*

3. Appellants were in lawful physical possession of the located chattels on date of bankruptcy; and no demand for the repossession thereof has been made upon them prior to bankruptcy.

We respectfully contend that for all and each of the reasons stated in this brief appellants were not guilty of conversion of their own property; and that a personal money judgment against them cannot be sustained under the Bankruptcy Act *in any amount.*

In the case of *Industrial Finance Corporation v. Caplemann,* 284 Fed. 8 at 11, the Court said:

> "When a state recording statute, as construed by the state court, only provides for protection against unrecorded instruments of 'lien creditors' or 'creditors who have fastened a lien on the property' or 'creditors armed with judicial process,' or the like, it has been held that the trustee cannot recover the property when the holder of an unrecorded mortgage or other instrument requiring record *acquires possession before the filing of the petition in bankruptcy.* This holding is on the express ground that the rights of no creditors had attached to any of the property until the petition was filed; that the trustee did not until then acquire the right of a lien creditor, and therefore *could not recover property which had bona fide passed from the possession and ownership of the bankrupt before the petition was filed. Hart v. Emmerson-Brantingham Co.* (D. C.), 203 Fed. 60." (Italics ours.)

See also *Wolfert v. Gripton,* 213 Cal. 474 at 480, paragraph No. 2, where the Court says:

> "Our law provides that a mortgage of personal property is void as against creditors of the mortgagor unless it is recorded in the office of the county recorder of the county in which the mortgagor resides, if the mortgagor be a resident of this state, and in the county in which the property mortgaged is situate. (Civ. Code, secs. 2957, 2959.) However, since an unrecorded chattel mortgage is good as between the parties thereto, *a mere general creditor* of the mortgagor is not in a position to attack its validity. (*Loosemore v. Baker,* 175 Cal. 420, 422 (116 Pac. 26); *Lemon v. Wolff,* 121 Cal. 272, 275 53 Pac. 810.) Only a creditor who has acquired a

> lien upon the mortgaged property by virtue of some legal proceeding, or who is armed with some process authorizing seizure of the property, can question its compliance with the formalities prescribed by the code." (Italics ours.)

In the case of *Roder v. Boyd,* 252 F. 2d 585 at 586, the Court said (citing numerous cases in support thereof):

> "A Court of bankruptcy is a court of equity, exercising equitable powers of broad sweep. And, within the statutory scheme, the Court may exert such powers in full vigor with respect to the allowance, rejection or subordination of claims. It is empowered to 'sift the circumstances surrounding any claim to see that injustice and unfairness is not done in the administration of the bankruptcy estate.' "

Conclusion.

The order of the District Judge indicates that he gave no consideration to the legal points discussed in the memorandum decision of the Referee, which as pointed out in the forepart of this brief covered the precise legal points presented by the factual record herein.

The order of the District Judge further indicates that he gave no consideration to the all important point that the purchase price mortgage was valid against all of the creditors for the reasons and on the grounds discussed under heading IV of this brief at pages 19-22.

Nor did Judge Harrison consider the California State law discussed under heading III of this brief at pages 15-18.

The order of the District Judge further indicates that the basis of his adverse ruling against appellants rested

solely on Section 70(e) of the Bankruptcy Act considered in isolation from the other related sections of the Bankruptcy Act.

We respectfully urge that the order of the District Judge should be vacated, and that the order of the Referee should be modified by deleting therefrom Conclusion of law numbered VI at page 58 of the record; and also No. 2 of the order at page 59 of the record.

Respectfully submitted,

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APPENDIX.

Excerpts from *In re Mercury Engineering Co,* 68 Fed. Supp. 376:

At page 380:

"The claimant here, Arthur E. Barili, for a long time prior to June 26, 1943, owned and operated a machine shop at 722 North Broadway, Los Angeles, California. On that day he sold it as a going concern to Charles B. Taylor, who was acting not for himself but as Trustee for Mercury Engineering Company Incorporated, a corporation in the process of formation, for a total sum of $16,000. Barili received $5,000 in cash and the balance was to be evidenced by a promissory note in the sum of $11,000 secured by a chattel mortgage upon the business, machinery and equipment sold. The chattel mortgage is undated, but was acknowledged on June 30th, and delivered to Barili. The company was formed on July 6th and thereafter the machine shop and business were transferred to the new corporation by Taylor, the Trustee. The corporation did not complete its organization and start business until the week ending Saturday, July 4th. During the week, Barili remained at the place of business. The following Monday, July 26th, the chattel mortgage was recorded."

* * * * * * * * *

At page 378:

". . . the chattel mortgage is first challenged because of failure to comply with Section 3440 of the California Civil Code . . ."

At page 379:

* * * * * * * * *

"We need not go into a detailed discussion of this section. It has its duplicate in almost every state in the Union, including the State of New York. California Courts do not seem to have been called upon to determine whether its provisions apply *to a purchase price chattel mortgage.* But the referee rightly concluded that it did not so apply upon no less an authority than the Circuit Court of Appeals for the Second Circuit, whose opinions upon a matter of this character interpreting a New York statute of identical import with ours command not only respect, but require following when no contrary ruling in our own Circuit appears. *This is especially the case when the decision accords with the very philosophy which lies behind the enactment. Its object is to protect the creditors against a surreptitious sale or incumbrance of the chief assets or equipment of a trader. But when the incumbrance is to secure the moneys which represented the price of these assets, the reason for the requirement disappears. For to hold that the seller who, instead of receiving cash acquires a mortgage on property which he transfers to a buyer, must subordinate his rights to this buyer's other creditors, is to penalize him for supplying to the buyer the very means of carrying on a trade.* It would mean to subsidize the existing creditor who may have extended credit on the basis of ownership of other assets at the expense of the man who furnishes the stock in trade or equipment to carry on a business. When we require notice before sale of stock in trade, we do so in order that the basis on which the prior credit had been secured be not dissipated without notice. But when the basis did not exist, but came into being through the very sale and incumbrance, the very foundation for the

requirement is gone. Nor is there merit to the contention that the chattel mortgage was invalid because of failure to comply with the requirement of Section 2957 of the Civil Code of California, which calls for recordation in the county where the mortgagor resides and the county where the property is located. Non-compliance with the section either by failure to record or long delay in recording, renders the chattel mortgage invalid as against prior or subsequent creditors. Because the requirement as to recording takes the place of the immediate delivery and change of possession required in other cases, the Courts have held that this requirement is satisfied only if the recording is done promptly, unless such recording is impractical or the circumstances of the case warrant delay. In giving effect to these rulings, the Referee found that the short delay in recording the chattel mortgage was justified. The conclusion is warranted by the facts." (Italics supplied.)

* * * * * * * * *

Civil Code, Section 2957, reads in relevant part as follows:

"A mortgage of personal property or crops is void as against creditors of the mortgagor and subsequent purchasers and encumbrances of the property in good faith and for value, unless . . .

"The mortgage, if of animate personal property other than crops growing or to be grown, is recorded in the office of the recorder of the county where the mortgagor resides at the time the mortgage is executed, or in case the mortgagor is a nonresident of this State, in the office of the recorder of the county where the property mortgaged is located at the time the mortgage is executed."

* * * * * * * * *

Civil Code, Section 2973, reads as follows:

"Mortgages of personal property, other than mentioned in section twenty-nine hundred and fifty-five, and mortgages not made in conformity with the provisions of this article, are nevertheless valid between the parties, their heirs, legatees, and personal representatives, and persons who, before parting with value, have actual notice thereof."